

# **Final White Paper on Task 4, Step 1: Insurance Product**

**Produced under contract by: ICF Consulting Services, LLC  
September 14, 2007**

**for the  
California Integrated Waste Management Board**

## **Financial Assurance and Corrective Action Contracted Study**

Task 4 involves developing a mandatory insurance product for the landfills in the study universe that would provide financial assurance for defaults of PCM and CA on the parts of private sector and public sector responsible parties.

Key issues include the following:

- (1) definitions of PCM and CA
- (2) definition of default (failure to perform)
- (3) potential limits
- (4) potential exclusions for certain causes of defaults of PCM and/or CA
- (5) cancellation, termination, non-renewal, rescission/voiding
- (6) setting/raising of premiums and/or retrospective assessments
- (7) claims management
- (8) coordination with other FA
- (9) timely payout to CIWMB

**(1) Definitions of PCM and CA.** Because the policy is intended to cover these activities, how they are defined is crucial. For purposes of the study:

- Post Closure Maintenance means all activities undertaken at a closed solid waste management unit to maintain the integrity of containment features and to monitor compliance with applicable performance standards. This is work that is performed regularly or periodically to deal with routine wear and tear of containment features. It does not include repairs of containment features damaged as a result of major events, such as floods, stormwater runoff, earthquakes, or fires; nor does it include repairs of containment features damaged due to poor design, improper installation, or inadequate maintenance.
- Corrective Action means activities undertaken at an active or closed solid waste management unit needed to remediate a known release that has occurred to the environment, or activities that would need to be undertaken at an active or closed unit to restore the integrity of damaged containment, gas extraction, and drainage features. It can include non-routine repairs, such as repairing covers and drainage systems damaged as a result of major events,

such as floods, stormwater runoff, earthquakes, or fires; as well as repairs of containment features damaged due to poor design, improper installation, or inadequate maintenance.

**(2) Definition of Start of Default.** For this study, we have been defining default as a failure to perform PCM and/or CA. For the insurance policy/endorsement, we need a formal definition so that there is no question about whether a “default” has occurred or not. Options include:

- (a) An existential description (e.g., insured ceased conducting PCM for at least X days as evidenced by failure to inspect the site)
- (b) A determination documented by an official letter (from the CIWMB) informing the insurer that the insured has “failed to perform.” Receipt of that letter by the insurer would start coverage. Definition of default to be added to CIWMB FA regulations.
- (c) The insured could self-certify its failure to perform

ICF recommends option (b). Option (a) could be difficult to craft to cover all relevant performance default situations, and option (c) has a high degree of moral hazard. To avoid appearing arbitrary and capricious, the letter could include supporting rationale as to why the agency has arrived at the default determination; however, that may give the insurer the opportunity to contest the default designation.

The insurance policy/endorsement also will need a definition of when a default ends. ICF recommends an option analogous to (b) above, which also could be initiated by the insurer. The white paper on modeling defaults in the working model has some discussion of the duration of default and the prospect of a “permanent” default. In general, ICF believes that permanent defaults will occur very rarely because we believe that most landfills will be attractive to someone at some price who can become the new responsible party. ICF wishes to raise the option of including in the insurance policy an opportunity for the insurer to find a new responsible party to take over the landfill if there is a “permanent” default. The insurer would have a strong financial incentive to find a replacement responsible party. The insurer would need to find a bona fide party because otherwise, if the new party failed to perform, the obligation would go back to the insurer; so there is little risk that the insurer will find a financially marginal, replacement responsible party.

**(3) Potential Limits.** It is common practice in the insurance industry to establish dollar limits of liability in policies and endorsements, although the California Insurance Code does not seem to require that policies include such limits (see Division 1, Chapter 4). CIWMB regulations for PCM and CA insurance provide that policies be issued at face amounts at least equal to the most recently approved cost estimates. Options for policy limits include the following:

- (a) No specified dollar limits;
- (b) Limits based on the most recent, approved cost estimates.
- (c) Set limits at some multiple of (e.g., twice) the most recent cost estimates.
- (d) Establish a schedule of dollar limits for different size LFs that would be unlikely to be exceeded (e.g., 90-95%) by actual PCM and/or all CA expenditures.

The best option would be to avoid having any liability limits at all for PCM; the insurance should cover defaults until the waste no longer poses a threat. Although we may have reasonably complete cost estimates for PCM, especially after revisions to the cost estimating regulations, a dollar limit for PCM would require knowing for how long the PCM would be necessary. That is unknowable. For CA, the insurance should cover all CA activities until an NFA-type letter is issued by the responsible regulator. Some CAs may require lengthy time periods and large expenditures to complete with uncertain end dates. Some LFs may require multiple CAs. However, this option may discourage insurers from being willing to offer coverage.

Setting the limits based on recent approved cost estimates may create a risk that the insurance will leave CA and/or PCM under-funded because (a) the LF may require more than 30 years of PCM and (b) the regulations do not require LFs to estimate the costs of all potential CAs, just those that have commenced or those that are reasonably foreseeable. Setting policy limits at a multiple of the cost estimates may provide more assurance but appears arbitrary and may nonetheless still not be enough coverage. Coming up with an appropriate schedule of fixed dollar limits has the same difficulties and risks of under-coverage; results from the working model may offer guidance and a basis for such limits, on the other hand.

**(4) Potential Exclusions for Certain Causes of Failure to Perform PCM and/or CA.**

Another common insurance industry practice is to exclude certain situations from coverage. For example, an insurer might want to exclude failures to perform PCM and/or CA that result from earthquakes, on the theory that separate earthquake insurance coverage should cover such damages; a variation on this example would be to exclude coverage of CA if the need for CA were due to an earthquake. Or an insurer might want to exclude failures to perform PCM and/or CA due to strikes and other labor issues.

Regardless, ICF recommends that no exclusions from coverage due to the cause of a default be acceptable. That is the best way to ensure adequate financial coverage to protect the state's taxpayers. However, exclusions of issues (e.g., conventional commercial auto insurance) outside the required scope of coverage would be acceptable.

The insurer also should be granted subrogation rights to pursue, on its own nickel, parties and their insurers that might be considered responsible for causing the default.

**(5) Cancellation, Termination, Non-renewal, and Voiding/Rescission.** Current CIWMB

regulations for PCM and CA insurance state that the insurer may not cancel, terminate, or fail to renew a policy except for failure to pay premiums. These are excellent baseline requirements that reflect the California Insurance Code (see Division 1, Part 1 Chapters 9 & 10). However, as a result of such provisions being used around the country, insurers have been making greater use of voiding/rescission powers in state insurance codes, where insurers can extract themselves from policies under the theory that there was fraud or misrepresentation on the part of the insureds. ICF recommends plugging that option, as allowed for UST policies following litigation with Zurich. ICF needs to check the rescission provisions in the California Insurance Code to assess whether such escapes from coverage can be blocked. In addition, to reduce the possibility of cancellation due

to failure to pay premiums, premium payments can be front-loaded so that after a 1-3 year period, all premiums will have been paid.

**(6) Setting/Raising Premiums and Retrospective Assessments.** If cancellation, termination, and non-renewal is permitted for failure to pay premiums, and failure to pay premiums is a symptom of financial distress, then insurance coverage could disappear just when it is most needed. Moreover, if the insurer has unfettered power to raise premiums, it can encourage insureds to stop paying premiums by significantly raising the price of coverage, thus leading to cancellation, termination, or non-renewal. ICF recommends that premiums be front-loaded and that there be controls on premium magnitudes at the start. On the other hand, if defaults prove to be much greater than anticipated, it may be reasonable to allow the insurer to collect some amount of retrospective assessments from its insureds.

ICF believes that it is important to balance an insurer's need to make money on its insurance programs (or at least not lose money) with the notion that insurance entails some risk of loss for the insurer. This suggests allowing the insurer some flexibility to adjust premiums to reflect loss experience but not guaranteeing that the insurer will necessarily make money.

**(7) Claims Management.** Insurers typically desire to manage claims by such practices as reserving the right to select its contractor to perform CA and/or PCM, to review and approve rates for paying its contractors and invoices for the activities they perform, and related controls over expenditures. This can be a source of friction with regulatory agencies, which may have a different view about the proper conduct of PCM and/or CA. ICF recommends that claims management not be outsourced to the insurer or that acceptable regulatory checks and balances be included in the policy.

**(8) Coordination of Coverage with Other FA.** ICF will need to define how to coordinate the umbrella coverage offered by the policy with underlying FA for PCM and/or CA. This likely will be handled through notification of claims and payout rules.

**(9) Timely Payout to CIWMB.** CIWMB regulation for FA using insurance as amended in a proposed rulemaking can be employed for the umbrella insurance product. Thus, if either PCM or CA activities are ordered by the CIWMB, EA, or other government entity or court of competent jurisdiction as a result of failure by the operator or other authorized person to conduct such activities, the policy shall guarantee that the insurer shall be responsible for paying out funds to the CIWMB for deposit into a special account established by the CIWMB for PCM or CA activities of the facility. The policy shall further guarantee that the insurer shall, without delay, pay to the CIWMB the amount the CIWMB requests, up to an amount equal to the face amount of the policy, regardless of any remaining premiums to be paid. CIWMB requests for payment will be based on estimated expenses as determined by the CIWMB for PCM or CA activities. Any payments made by the insurer that exceed the actual expenses incurred in performing the insured activity will be repaid to the insurer at the completion of the insured activity.

